

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

FINANCIAL STATEMENTS

and

ADDITIONAL INFORMATION

with

INDEPENDENT AUDITOR'S REPORT

YEARS ENDED DECEMBER 31, 2011 AND 2010

George, Bowerman & Noel, P.A.

Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Artesian Valley Health System
a/k/a Meade Hospital District
Meade, Kansas

We have audited the financial statements of the Artesian Valley Health System a/k/a Meade Hospital District (the System), as listed in the table of contents, at and for the years ended December 31, 2011 and 2010. These financial statements are the responsibility of the System's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Artesian Valley Health System a/k/a Meade Hospital District as of December 31, 2011 and 2010, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 2 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were made for the purpose of forming opinions on the basic financial statements taken as a whole. The additional information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to the prepare the basic financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

George, Bowerman & Noel, P.A.

Wichita, Kansas
June 14, 2012

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Artesian Valley Health System a/k/a Meade Hospital District (the System's) financial performance provides an overview of the System's financial activities for the fiscal years ended December 31, 2011 and 2010. Please read it in conjunction with the System's financial statements, which begin on page 8.

Financial Highlights

- The System's net assets decreased in 2011 by \$317,895 or 7.11% compared to a decrease in 2010 of \$366,908 or 7.59%.
- Contractual allowances, charity care and bad debts reduced gross patient service revenue by \$3,355,964 or 21.56% of gross patient service revenue in 2011 and by \$3,479,924 or 22.02% of gross patient service revenue in 2010.
- Other operating revenue increased in 2011 by \$495,400 or 816.47% over the amounts for 2010. This was primarily due to the accrual of approximately \$516,000 of revenue for the Medicare and Medicaid electronic health record incentive program as discussed in Note 2 to the financial statements.
- The System reported an operating loss in both 2011 (\$1,220,891) and 2010 (\$1,264,235). The operating loss in 2011 decreased by \$43,344 or 3.43% from the loss reported in 2010. The operating loss in 2010 increased by \$62,494 or 5.20% over the loss reported in 2009.
- Net nonoperating revenues/expenses increased by \$5,669 or 0.63% in 2011 compared to an increase in 2010 of \$22,016 or 2.52%.

Financial Statements

The System's financial statements are prepared using proprietary fund accounting that focuses on the determination of changes in net assets, financial position and cash flows in a manner similar to private-sector businesses. The financial statements are prepared on an accrual basis of accounting which recognizes revenue when earned and expenses when incurred. The basic financial statements include a *balance sheet*, *statement of revenue, expenses and changes in net assets*, and *statement of cash flows*, followed by notes to the financial statements and schedules of certain additional information.

The *balance sheet* presents information on the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net

assets may indicate whether the financial position of the System is improving or deteriorating.

The *statement of revenues, expenses and changes in net assets* presents both the operating revenues and expenses and nonoperating revenues and expenses along with other changes in net assets for the year. This statement is an indication of the success of the System's operations over the past year.

The *statement of cash flows* presents the change in cash and cash equivalents for the year resulting from operating activities, capital and related financing activities and investing activities. The primary purpose of this statement is to provide information about the System's cash receipts and cash payments during the year.

Financial Position

The information below summarizes the System's net assets as of December 31, 2011, 2010 and 2009.

	December 31,		
	2011	2010	2009
Assets:			
Current assets	\$ 4,815,757	\$ 5,289,258	\$ 5,433,945
Capital assets, net	6,630,023	7,158,046	7,627,941
Other noncurrent assets	<u>105,888</u>	<u>123,520</u>	<u>141,882</u>
Total assets	<u>\$11,551,668</u>	<u>\$12,570,824</u>	<u>\$13,203,768</u>
Liabilities:			
Long-term liabilities	\$ 4,905,795	\$ 5,406,404	\$ 5,896,811
Other liabilities	<u>2,495,161</u>	<u>2,695,813</u>	<u>2,471,442</u>
Total liabilities	<u>\$ 7,400,956</u>	<u>\$ 8,102,217</u>	<u>\$ 8,368,253</u>
Net assets:			
Invested in capital assets, net	\$ 1,245,292	\$ 1,284,292	\$ 1,276,020
Restricted	392,454	404,476	420,118
Unrestricted	<u>2,512,966</u>	<u>2,779,839</u>	<u>3,139,377</u>
Total net assets	<u>\$ 4,150,712</u>	<u>\$ 4,468,607</u>	<u>\$ 4,835,515</u>

Recent Financial Performance

The schedule below is a summary of the System's revenues, expenses and changes in net assets for the years ended December 31, 2011, 2010 and 2009.

	Year ended December 31,		
	2011	2010	2009
Operating revenue	<u>\$12,763,386</u>	<u>\$12,382,706</u>	<u>\$ 14,111,930</u>
Operating expenses:			
Salaries	7,158,734	7,114,527	7,992,771
Employee benefits	2,090,652	1,966,366	1,957,131
Supplies and other	3,845,814	3,731,751	4,524,006
Depreciation and amortization	<u>889,077</u>	<u>834,297</u>	<u>839,763</u>
Total operating expenses	<u>13,984,277</u>	<u>13,646,941</u>	<u>15,313,671</u>
Operating loss	<u>(1,220,891)</u>	<u>(1,264,235)</u>	<u>(1,201,741)</u>
Nonoperating revenues (expenses):			
Taxes	974,752	976,489	978,676
Investment income	18,962	17,923	71,282
Interest expense	(217,833)	(235,965)	(252,784)
Grants and contributions	50,310	47,320	38,860
Other, net	<u>76,805</u>	<u>91,560</u>	<u>39,277</u>
Total nonoperating revenues (expenses)	<u>902,996</u>	<u>897,327</u>	<u>875,311</u>
Decrease in net assets	<u>\$ (317,895)</u>	<u>\$ (366,908)</u>	<u>\$ (326,430)</u>
Net assets at end of year	<u>\$ 4,150,712</u>	<u>\$ 4,468,607</u>	<u>\$ 4,835,515</u>

Overall, operating revenues increased 3.00% from 2010 to 2011 and decreased 12.25% from 2009 to 2010.

- Net patient service revenue increased 2% from 2010 to 2011 as compared to a decrease of 14% from 2009 to 2010. The significant decline in patient service revenue in 2010 was due primarily to the closure of a physician's clinic practice and the termination of the contract with Heritage for geriatric-psychiatry services.
- Other operating revenues increased significantly from 2010 to 2011 primarily due to the electronic health record incentive program mentioned above.

Overall, operating expenses increased 2.47% from 2010 to 2011 and decreased 10.88% from 2009 to 2010.

- Salaries, wages, and employee benefits increased 1.86% from 2010 to 2011 and decreased 8.73% from 2009 to 2010.

- Supplies and other expenses increased 12.77% from 2010 to 2011 primarily due to the imposition of assessments by the Kansas Department on Aging, increases in surgical supplies and implantable devices, increases in medical supplies and drugs, and increases in maintenance costs for computer system hardware and software.
- Purchased services expense decreased 19.03% from 2010 to 2011 primarily due to the termination of the contract with Heritage for geriatric-psychiatric services mentioned above.
- Equipment depreciation increased 15.85% from 2010 to 2011 primarily due to significant acquisitions made for the electronic health record system mentioned above.

Overall, the System's operating loss decreased 3.43% from 2010 to 2011 and increased 5.20% from 2009 to 2010 due primarily to the items mentioned above. It is important to note that the calculation of the operating loss is a result of the application of accounting principles generally accepted ("GAAP") in the United States of America. The System receives tax revenues in part to subsidize the cost of services provided to uninsured patients. Although the expenses incurred to provide these services are recognized as operating expenses, GAAP reporting rules require that the tax revenues be reported as non-operating revenues.

Non-operating revenues and expenses consist primarily of property taxes levied by the System, interest expense on long-term debt, and grants and contributions.

Patient Volumes

Patient volumes are measured on both an inpatient and outpatient basis. Pertinent patient volume statistics are summarized in the following table:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Inpatient acute days	945	1,181	1,541
Observation bed days	<u>324</u>	<u>144</u>	<u>133</u>
	<u>1,269</u>	<u>1,325</u>	<u>1,674</u>
Percent change	<u>(4.23)%</u>	<u>(20.85)%</u>	<u>(2.90)%</u>
Swing bed days	<u>936</u>	<u>953</u>	<u>1,349</u>
Percent change	<u>(1.78)%</u>	<u>(29.36)%</u>	<u>3.21%</u>
LTCU days	<u>16,979</u>	<u>17,613</u>	<u>17,396</u>
Percent change	<u>(3.60)%</u>	<u>1.25%</u>	<u>5.25%</u>
RHC visits	<u>10,530</u>	<u>10,577</u>	<u>12,096</u>
Percent change	<u>(0.44)%</u>	<u>(12.56)%</u>	<u>(.97)%</u>

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Outpatient visits	<u>10,738</u>	<u>10,432</u>	<u>12,330</u>
Percent change	<u>2.93%</u>	<u>(15.39)%</u>	<u>(1.12)%</u>

Capital Assets

At the end of 2011, the System had \$6,630,023 invested in capital assets, net of accumulated depreciation, as detailed in Note 9 to the financial statements. The System acquired additional capital assets costing \$343,422 and \$346,040 in 2011 and 2010, respectively. Of this, approximately \$275,000 and \$184,000 consisted of hardware and software relating to the implementation of electronic health record systems in 2011 and 2010, respectively.

Debt

At December 31, 2011, the System had \$4,885,000 of general obligation bonds outstanding that had been issued to finance the construction of the new facility that opened in 2004. In addition, the System had \$330,000 of certificates of participation outstanding that had been issued in 2005 to finance the acquisition of a local nursing home facility to be utilized as a long-term care unit.

The System also leases imaging equipment under a capital lease agreement with a remaining outstanding balance of approximately \$170,000 at December 31, 2011.

Other Economic Factors

The assessed valuation for the System for 2012 is \$89,917,863 an increase of \$6,877,729 over the 2011 assessed valuation amount of \$83,040,134. The total ad valorem taxes levied for 2012 was \$954,444 compared to \$933,787 for 2011.

In June 2010, a staff physician terminated his employment with the System to pursue other opportunities. Accordingly, a significant decrease in patient service revenue was incurred by the System. Management anticipated a reduction in patient volumes and has implemented strategies to address staffing levels and other operating expenses to adapt to lower volume levels expected in the near term.

Issues Facing the System

There are issues facing the System that could result in material changes in its financial position in the long term. Among these issues are:

- Risks related to Medicare and Medicaid reimbursement. A significant portion of the System's revenues are derived from the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. The funding of

these programs by the federal and state governments face increasing pressure due to the significant increases in the costs of providing healthcare services in recent years.

- Healthcare reform. In 2010, the federal government enacted sweeping new legislation that will significantly impact virtually all aspects of the healthcare delivery and insurance systems in the country. Portions of the legislation will be implemented over the next several years. However, most of the detailed implemented regulations have not yet been issued and accordingly, any specific effects on operations of the System are currently undeterminable. Management continues to closely monitor the progression of the implementation of the legislation.
- Employment and labor issues. The System is a major employer within the community, employing a complex mix of professional, technical, clerical, maintenance, dietary, and other workers. Risks include personal tort actions, work-related injuries and exposure to hazardous materials. A relative shortage of nursing and other medical professional/technical employees, is an issue that is causing salary and benefits costs to increase at significant rates.
- Technology and services. Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, and outpatient healthcare delivery may reduce utilization and revenues for the System in the future. Technological advances continue to accelerate the need to acquire sophisticated and expensive equipment and services for diagnosis and treatment of illnesses and diseases.

As part of the new legislation passed in 2009 and 2010, the federal government is providing financial incentives to healthcare providers to join in implementing a national electronic health record (EHR) system. Accordingly, the System has incurred significant expenditures for hardware and software to meet the requirements for the program. The System's initial EHR system implementation was approved by the Medicare and Medicaid fiscal intermediaries in 2011.

- Increasing numbers of uninsured and underinsured patients. Due to the significant increases and high cost of healthcare insurance premiums in recent years, increasing numbers of patients of the System are finding it more and more difficult to obtain or maintain adequate health insurance coverage. This trend could increase the levels of uncompensated care provided by the System.

Contacting The System's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Administration Department, at 510 E. Carthage, Meade, Kansas, 67864.

ARTESIAN VALLEY HEALTH SYSTEM**a/k/a MEADE HOSPITAL DISTRICT****BALANCE SHEETS**ASSETS

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Current assets:		
Cash (Notes 1 and 3)	\$ 1,606,449	\$ 2,542,830
Accounts receivable, net of allowance for doubtful accounts of \$1,063,498 in 2011 and \$787,537 in 2010	1,199,967	1,327,487
Uncollected current property taxes receivable (Note 1)	935,729	915,440
Other receivables	54,087	38,765
Estimated third-party payer settlements (Note 2)	480,703	—
Inventories (Note 1)	419,364	387,255
Prepaid expenses	<u>119,458</u>	<u>77,481</u>
Total current assets	<u>4,815,757</u>	<u>5,289,258</u>
Property and equipment, at cost (Notes 1, 4 and 9):		
Land	86,142	86,142
Land improvements	1,278,116	1,278,116
Buildings and fixed equipment	7,705,903	7,679,300
Movable equipment	<u>5,619,101</u>	<u>5,302,282</u>
Total property and equipment	14,689,262	14,345,840
Less accumulated depreciation	<u>8,059,239</u>	<u>7,187,794</u>
Net property and equipment	<u>6,630,023</u>	<u>7,158,046</u>
Other assets:		
Debt issuance cost – net of accumulated amortization of \$48,866 in 2011 and \$42,529 in 2010 (Note 1)	29,284	35,621
Deferred loss on refunding – net of accumulated amortization of \$56,551 in 2011 and \$45,256 in 2010 (Notes 1 and 4)	<u>76,604</u>	<u>87,899</u>
Total other assets	<u>105,888</u>	<u>123,520</u>
Total assets	<u>\$ 11,551,668</u>	<u>\$ 12,570,824</u>

LIABILITIES AND NET ASSETS

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Current liabilities:		
Accounts payable	\$ 165,259	\$ 332,403
Salaries and payroll taxes payable	307,326	265,527
Estimated third-party payer settlements (Note 2)	—	82,878
Current portion of compensated absences payable (Note 1)	502,830	520,143
Current portion of long-term debt (Note 4)	499,888	489,023
Accrued interest payable	84,129	90,399
Unearned revenue - uncollected current property taxes receivable (Note 1)	<u>935,729</u>	<u>915,440</u>
Total current liabilities	<u>2,495,161</u>	<u>2,695,813</u>
Long-term debt (Note 4)	4,884,843	5,384,731
Compensated absences payable (Note 1)	<u>20,952</u>	<u>21,673</u>
Total non-current liabilities	<u>4,905,795</u>	<u>5,406,404</u>
Total liabilities	<u>7,400,956</u>	<u>8,102,217</u>
Net assets (Notes 1 and 7):		
Invested in capital assets net of related debt	1,245,292	1,284,292
Restricted – expendable for specific operating activities	392,454	404,476
Unrestricted	<u>2,512,966</u>	<u>2,779,839</u>
Total net assets	<u>4,150,712</u>	<u>4,468,607</u>
Total liabilities and net assets	<u>\$ 11,551,668</u>	<u>\$ 12,570,824</u>

The accompanying notes are an integral
part of the financial statements.

ARTESIAN VALLEY HEALTH SYSTEM**a/k/a MEADE HOSPITAL DISTRICT****STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

	<u>Year ended December 31,</u>	
	<u>2011</u>	<u>2010</u>
Operating revenues:		
Net patient service revenue (Note 1)	\$ 12,207,310	\$ 12,322,030
Other (Note 2)	<u>556,076</u>	<u>60,676</u>
Total operating revenues	<u>12,763,386</u>	<u>12,382,706</u>
Operating expenses:		
Salaries	7,158,734	7,114,527
Employee benefits	2,090,652	1,966,366
Purchased services	477,834	590,172
Medical supplies and drugs	1,169,872	1,122,945
Other supplies and expense	2,198,108	2,018,634
Depreciation and amortization	<u>889,077</u>	<u>834,297</u>
Total operating expenses	<u>13,984,277</u>	<u>13,646,941</u>
Operating loss	<u>(1,220,891)</u>	<u>(1,264,235)</u>
Nonoperating revenues (expenses):		
Taxes for operations	441,488	436,066
Taxes for debt service	533,264	540,423
Investment income	18,962	17,923
Interest expense	(217,833)	(235,965)
Noncapital grants and contributions	50,310	47,320
Other	<u>76,805</u>	<u>91,560</u>
Total nonoperating revenues	<u>902,996</u>	<u>897,327</u>
Decrease in net assets	(317,895)	(366,908)
Net assets at beginning of year	<u>4,468,607</u>	<u>4,835,515</u>
Net assets at end of year	<u>\$ 4,150,712</u>	<u>\$ 4,468,607</u>

The accompanying notes are an integral
part of the financial statements.

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

STATEMENTS OF CASH FLOWS

	<u>Year ended December 31,</u>	
	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 12,287,511	\$ 13,077,605
Payments to suppliers and contractors	(4,153,222)	(3,555,576)
Payments to and on behalf of employees	(9,225,621)	(9,154,724)
Other receipts and payments, net	<u>39,814</u>	<u>60,676</u>
Net cash flows provided (used) by operating activities	<u>(1,051,518)</u>	<u>427,981</u>
Cash flows from noncapital financing activities:		
Property taxes for operations	441,488	436,066
Grants and contributions	50,310	47,320
Other	<u>76,805</u>	<u>91,560</u>
Net cash flows provided by noncapital financing activities	<u>568,603</u>	<u>574,946</u>
Cash flows from capital and related financing activities:		
Property taxes for debt service	533,264	540,423
Principal payments on long-term debt	(489,023)	(478,167)
Interest paid on long-term debt	(224,103)	(242,115)
Purchases of capital assets	<u>(292,566)</u>	<u>(346,040)</u>
Net cash flows used by capital and related financing activities	<u>(472,428)</u>	<u>(525,899)</u>
Cash flows from investing activities – Investment income	<u>18,962</u>	<u>17,923</u>
Net increase (decrease) in cash and cash equivalents	(936,381)	494,951
Cash and cash equivalents at beginning of year	<u>2,542,830</u>	<u>2,047,879</u>
Cash and cash equivalents at end of year	<u>\$ 1,606,449</u>	<u>\$ 2,542,830</u>

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

STATEMENTS OF CASH FLOWS - continued

	<u>Year ended December 31,</u>	
	<u>2011</u>	<u>2010</u>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (1,220,891)	\$ (1,264,235)
Adjustments to reconcile operating loss to net cash flows used in operating activities:		
Depreciation and amortization	889,077	834,297
Provision for doubtful accounts	565,174	425,860
Net (increases) decreases in current assets:		
Accounts receivable	(437,654)	(266,474)
Property taxes receivable	(20,289)	(22,008)
Inventories	(32,109)	20,799
Estimated third-party payor settlements	(480,703)	513,311
Other current assets	(57,299)	(31,850)
Net increases (decreases) in current liabilities:		
Accounts payable	(224,270)	181,076
Compensated absences payable	(18,034)	(34,616)
Salaries and wages payable	41,799	(39,215)
Estimated third-party payor settlements	(82,878)	82,878
Accrued interest payable	6,270	6,150
Unearned revenue-uncollected current property taxes	<u>20,289</u>	<u>22,008</u>
Net cash provided (used) by operating activities	<u>\$ (1,051,518)</u>	<u>\$ 427,981</u>

The accompanying notes are an integral part of the financial statements.

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations and reporting entity

Meade Hospital District (the District) is a political subdivision of the state of Kansas organized under the hospital district statutes of the state. The District owns and operates the Artesian Valley Health System (the System). The System is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

The System operates an acute care hospital, long-term care unit, and rural health clinic and is located in Meade, Kansas. The System primarily earns revenues by providing inpatient, outpatient, emergency care, long-term care, physician clinic, and home health services to patients in the Meade County, Kansas area.

Basis of accounting and presentation

The financial statements of the System have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions. Property taxes, investment income, interest on capital assets-related debt are included in nonoperating revenues and expenses.

The System prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the System has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

For purposes of the statement of cash flows, the System includes checking accounts, certificates of deposit, savings accounts and NOW accounts as cash and cash equivalents.

Patient accounts receivable

The System reports patient accounts receivable (Note 6) for services rendered at net realizable amounts from third-party payers, patients and others. The System provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information, payer mix trends, and existing economic conditions. As a service to patients, the System bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are generally due in full when billed. If the patient is unable to pay the full amount at the time the patient is billed, the System negotiates a payment plan whereby monthly payments are made by the patient on the account. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account. If future actual default rates on accounts receivable differ from those currently anticipated, the System may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

Capital assets

The System's capital assets that are \$5,000 or greater, are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following estimated useful lives:

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Land improvements	4 years
Buildings	10-40 years
Equipment	5-20 years

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. When depreciable property is retired or otherwise disposed of, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is reflected as non-operating revenue (expense).

Property taxes receivable

In accordance with governing statutes, property taxes levied during the current year are a revenue source to be used to finance the budget of the ensuing year. Taxes are assessed on a calendar year basis and become a lien on the property on November 1st of each year. The County Treasurer is the tax collection agent for all taxing entities within the County. Property owners have the option of paying one-half or the full amount of the taxes levied on or before December 20th during the year levied with the balance to be paid on or before May 10th of the ensuing year. State statutes prohibit the County Treasurer from distributing taxes collected in the year levied prior to January 1st of the ensuing year. Consequently, for revenue recognition purposes, the taxes levied during the current year are not due and receivable until the ensuing year. At December 31 such taxes are a lien on the property and are recorded as taxes receivable, net of anticipated delinquencies, with a corresponding amount recorded as unearned revenue on the balance sheet.

Compensated absences payable

Employees of the System are entitled to paid time off depending on the length of service and whether they are full or part time. Upon resignation, termination or retirement from service with the System, employees with six or more months of employment are entitled to payment for all accrued hours, up to the allowable maximum. The System accrues paid time off benefits as earned.

Net assets

Net assets of the System are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted – expendable for specific operating activities* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the System. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted*.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Operating revenues and expenses

The System's statement of revenues, expenses, and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the System's principal activity. Non-exchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Net patient service revenue

The System has agreements with third-party payers that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per episode, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payers, and a provision for uncollectible accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity care

The System provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy based on current poverty level guidelines. Because the System does not pursue collection of amounts determined to qualify as charity care, these charges are not reported as net patient service revenue. The System provided \$109,910 and \$105,427 of charity care for the years ended December 31, 2011 and 2010, respectively estimated by multiplying the System's cost to charge ratio by the gross uncompensated care charges associated with providing care to charity patients.

Grants and contributions

From time to time, the System receives grants and contributions from government agencies, private organizations, and individuals. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenue. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses. When the System has both restricted and unrestricted resources available to finance a particular program, it is the System's policy to use restricted resources before unrestricted resources.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Budgetary principles

The System is required by state statute to adopt annual budgets using the modified accrual basis of accounting for the operation and maintenance, employee benefits and debt service funds on or before August 25 of the preceding year. The System's Board of Directors may amend the budget by transferring budgeted amounts from one object or purpose to another within the same fund. Expenditures may not legally exceed the total amount of the adopted budget of individual funds.

Under the modified accrual basis of accounting revenues are recognized when they become both measurable and available to finance expenditures of the current period. Expenditures are recognized when the related fund liability is incurred.

Applicable Kansas statutes require the use of an encumbrance system as a management control technique to assist in controlling expenditures. For budgetary purposes, encumbrances of the budgeted fund types, representing purchase orders, contracts and other commitments, are reported as a charge to the current year budget. All unencumbered appropriations lapse at the end of the year. There were no material encumbrances at December 31, 2011 and 2010. Budgeted revenue and expenditure amounts represent the original budget adopted by the System's Board of Directors.

The following reconciliation is presented to provide a correlation between the different basis of accounting for reporting in accordance with generally accepted accounting principles (GAAP) and for reporting on the budgetary basis:

	Operation and Maintenance <u>Fund</u>	Employee Benefit <u>Fund</u>	Debt Service <u>Fund</u>
GAAP basis net assets at December 31, 2011	\$ 3,766,419	\$ —	\$ 384,293
Adjustments:			
Net property and equipment	(6,630,023)	—	—
Debt issuance cost	(29,284)	—	—
Deferred loss on refunding	(76,604)	—	—
Accrued interest payable	84,129	—	—
Net long-term debt	<u>5,384,731</u>	<u>—</u>	<u>—</u>
Budgetary basis fund balance at December 31, 2011	<u>\$ 2,499,368</u>	<u>\$ —</u>	<u>\$ 384,293</u>

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Risk management

The System is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; natural disasters; and employee health benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial insurance coverage in any of the three preceding years.

The System pays fixed premiums for annual medical malpractice coverage under an occurrence-basis policy. The System accrues the expenses of its share of malpractice claim costs, if any, of reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate cost of any incident. Based on the System's own claims experience, no accrual, for medical malpractice costs has been made in the accompanying financial statements.

Deferred debt related cost

Debt issuance costs and deferred loss on refunding are being amortized over the life of the general obligation bonds and certificates of participation, as appropriate, using the interest method.

Subsequent events

Subsequent events have been evaluated through June 14, 2012, which is the date the financial statements were available to be issued.

Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation. The reclassifications had no effect on the change in net assets.

2. ESTIMATED THIRD-PARTY PAYER SETTLEMENTS

The System has agreements with third-party payers that provide for payments to the System at amounts different from its established rates. These payment arrangements include:

2. ESTIMATED THIRD-PARTY PAYER SETTLEMENTS (continued)

- **Medicare** – Inpatient, outpatient, and clinic services are paid based on cost reimbursement methodologies. The System is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the System and reviews thereof by the Medicare fiscal intermediary. Home health services are paid on prospectively determined rates per episode. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The System's classification of patients under the Medicare program and appropriateness of their admission are subject to an independent review by a peer review organization under contract with the System. The System's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through December 31, 2010.
- **Medicaid** – The System is reimbursed under a cost reimbursement methodology for inpatient acute and outpatient services. The System is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the System and reviews thereof by the Medicaid fiscal intermediary. The System's Medicaid cost reports have been reviewed by the Medicare fiscal intermediary through December 31, 2008.

Inpatient long-term care services for 2011 and 2010 are paid at prospectively determined per diem rates that are based on the patient's acuity.

Approximately 47% of net patient service revenue is from participation in the Medicare program for each of the years ended December 31, 2011 and 2010. Laws and regulations governing the Medicare program are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

During 2011, the System met the requirements for additional incentive payments from the Medicare and Medicaid programs upon the implementation of a qualifying electronic health record system. The expected incentive payments to be paid to the System in 2012 total approximately \$516,000 and, accordingly, these amounts have been accrued on the financial statements at December 31, 2011 as a receivable and other operating revenue.

The System has also entered into payment agreements with certain commercial insurance carriers and other third-party payer programs. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and cost reimbursement.

3. CASH AND INVESTED CASH

Deposits

Custodial credit risk for deposits is the risk that in the event of bank failure, the System's deposits may not be returned or the System will not be able to recover collateral securities in the possession of an outside party. The System's policy follows applicable State statutes and requires deposits to be 100% secured by collateral (pledged securities) valued at market, less the amount of the Federal Deposit Insurance Corporation (FDIC) insurance. State statutes define the allowable types of pledged securities.

The System's cash and investments at December 31, 2011 consisted of demand deposit, certificates of deposit, NOW, and savings accounts. At year end, the carrying amount of the System's deposits, which approximates their fair value, was \$1,606,179 with the bank balances of such accounts being \$1,819,559. Of the bank balances, \$464,786 was secured by federal depository insurance and the remaining balance of \$1,354,773 was covered by collateral held by the System's custodial banks in joint custody in the name of the System and its banks. The market value of those pledged securities held by the System's custodial banks was \$2,296,503 at December 31, 2011.

The remaining carrying amount of the System's cash and investments at December 31, 2011 consisted of cash on hand of \$270.

Investment policies

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The System does not have a formal investment policy. Investing activities are managed under the custody of the System's Chief Executive Officer and at the direction of the Board of Directors and in compliance with State statutes.

Applicable state statutes authorize the System to invest in (1) temporary notes or no-fund warrants issued by the System (2) time deposit, open accounts or certificates of deposit, with maturities of not more than two years, in commercial banks; (3) time certificates of deposit, with maturities of not more than two years, with state or federally chartered savings and loan associations or federally chartered savings banks, (4) repurchase agreements with commercial banks, state or federally chartered savings and loan associations or federally chartered savings banks; (5) United States treasury bills or notes with maturities as the governing body shall determine, but not exceeding two years; (6) the municipal investment pool maintained by the State Treasurer's office, and (7) trust departments of commercial banks.

4. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES

The following is a summary of changes in long-term debt and other noncurrent liabilities for the years ended December 31, 2011 and 2010:

4. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES
(continued)

	Balance At December 31, 2010	Additions	Reductions	Balance At December 31, 2011	Amounts Due Within One Year
Bonds and capital lease obligations:					
General obligation bonds	\$5,225,000	\$ —	\$ 340,000	\$4,885,000	\$ 350,000
Capital lease obligations	<u>648,754</u>	<u>—</u>	<u>149,023</u>	<u>499,731</u>	<u>149,888</u>
	<u>5,873,754</u>	<u>—</u>	<u>489,023</u>	<u>5,384,731</u>	<u>499,888</u>
Other liabilities:					
Compensated absences payable	<u>541,816</u>	<u>547,937</u>	<u>565,971</u>	<u>523,782</u>	<u>502,830</u>
Total noncurrent liabilities	<u>\$6,415,570</u>	<u>\$ 547,937</u>	<u>\$1,054,994</u>	<u>\$5,908,513</u>	<u>\$ 1,002,718</u>
	Balance At December 31, 2009	Additions	Reductions	Balance At December 31, 2010	Amounts Due Within One Year
Bonds and capital lease obligations:					
General obligation bonds	\$5,560,000	\$ —	\$ 335,000	\$5,225,000	\$ 340,000
Capital lease obligations	<u>791,921</u>	<u>—</u>	<u>143,167</u>	<u>648,754</u>	<u>149,023</u>
	<u>6,351,921</u>	<u>—</u>	<u>478,167</u>	<u>5,873,754</u>	<u>489,023</u>
Other liabilities:					
Compensated absences payable	<u>576,432</u>	<u>561,557</u>	<u>596,173</u>	<u>541,816</u>	<u>520,143</u>
Total noncurrent liabilities	<u>\$6,928,353</u>	<u>\$ 561,557</u>	<u>\$1,074,340</u>	<u>\$6,415,570</u>	<u>\$ 1,009,166</u>

4. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES **(continued)**

In December 2006, the System issued \$5,630,000 in general obligation bonds to advance refund \$5,390,000 of outstanding General Obligation Bonds, Series 2001 (Refunded Bonds). The advance refunding reduced the System's aggregate debt service payments by \$102,583 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$102,326.

The General Obligation Refunding Bonds, Series 2006 mature in various amounts ranging from \$35,000 to \$565,000 beginning on February 1, 2008 with the final payment due on February 1, 2022. Interest, at rates ranging from 3.85% to 4.25%, is due semiannually on February 1 and August 1 beginning on February 1, 2007. Interest expense on the bonds was \$200,352 and \$214,784 for 2011 and 2010, respectively.

The Board of Directors of the System are to make proper provision for the payment of principal and interest of the general obligation bonds, in whole or in part, by a tax levy.

Annual funding requirements to maturity for the general obligation bonds are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending December 31:			
2012	\$ 350,000	\$ 191,710	\$ 541,710
2013	360,000	176,623	536,623
2014	375,000	161,004	536,004
2015	400,000	144,535	544,535
2016	420,000	127,950	547,950
2017	435,000	111,382	546,382
2018	460,000	93,700	553,700
2019	480,000	74,900	554,900
2020	505,000	55,200	560,200
2021	535,000	34,133	569,133
2022	<u>565,000</u>	<u>11,583</u>	<u>576,583</u>
	<u>\$ 4,885,000</u>	<u>\$ 1,182,720</u>	<u>\$ 6,067,720</u>

Certificates of participation dated July 1, 2005 in the amount of \$735,000 were issued pursuant to a lease purchase agreement between the System, as lessee, and UMB Bank, N.A. as trustee and lessor. The lease purchase agreement provides for basic rent payments to be paid semi-annually beginning on December 1, 2005 with the final payment due on June 1, 2015. Interest rates on the certificates range from 3.20% to 4.25%. Interest expense under the lease purchase agreement was \$15,040 and \$17,884 for the years ended December 31, 2011 and 2010, respectively. The certificates of participation were issued to finance the acquisition of an existing long-term care facility.

4. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES **(continued)**

The System also leases certain imaging equipment under a capital lease agreement. Interest expense under the capital lease agreement was \$2,441 and \$3,297 for the years ended December 31, 2011 and 2010, respectively.

The imaging equipment lease and the certificates of participation qualify as capital leases for accounting purposes and, accordingly, have been recorded at the present value of the minimum lease payments at the date of lease inception.

The following is an analysis of the financial presentation of the above capital leases:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Land	\$ 26,266	\$ 26,266
Buildings	535,209	535,209
Movable equipment	380,456	380,456
	<u>941,931</u>	<u>941,931</u>
Accumulated depreciation	<u>339,267</u>	<u>242,664</u>
	<u>\$ 602,664</u>	<u>\$ 699,267</u>

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2011:

Year ending December 31,	
2012.....	\$ 163,716
2013.....	165,519
2014.....	109,726
2015.....	<u>91,913</u>
Total minimum lease payments	530,874
Less amount representing interest.....	<u>31,143</u>
Present value of net minimum lease payments	<u>\$ 499,731</u>

5. PENSION PLAN

The System maintains a defined contribution pension plan for its employees. Upon employment, all employees are eligible to participate in the plan. The plan requires that the employee contribute 5% and the employer contribute 9% of the employee's compensation. Benefits are 100% vested upon participation in the plan. Pension cost, which is funded as accrued, was \$660,180 and \$665,399 for the years ended December 31, 2011 and 2010.

6. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payers was as follows:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
Medicare	\$ 125,724	\$ 391,454
Medicaid	9,628	25,359
Commercial	639,977	489,007
Private pay	<u>1,488,136</u>	<u>1,209,204</u>
Gross accounts receivable	2,263,465	2,115,024
Less allowance for doubtful accounts	<u>1,063,498</u>	<u>787,537</u>
	<u>\$ 1,199,967</u>	<u>\$ 1,327,487</u>

State statutes place no limit on the amount the System may invest in any one issuer as long as the investments are adequately secured (Note 3). The System's allocation of cash and investments by depository as of December 31, 2011, is as follows:

Fowler State Bank	95%
Meade State Bank	5%

7. RESTRICTED NET ASSETS

Restricted, expendable net assets consist of cash and cash equivalents and are available for the following purposes:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
HIPAA programs	\$ 8,161	\$ 7,075
Debt service for general obligation bonds	<u>384,293</u>	<u>397,401</u>
	<u>\$ 392,454</u>	<u>\$ 404,476</u>

Net assets were released from restrictions by incurring expenses satisfying the restricted purposes for the following:

	<u>December 31,</u>	
	<u>2011</u>	<u>2010</u>
HIPAA programs	\$ 7,075	\$ 7,424
Debt service for general obligation bonds	<u>546,372</u>	<u>555,717</u>
	<u>\$ 553,447</u>	<u>\$ 563,141</u>

8. OTHER POST EMPLOYMENT BENEFITS

As provided by K.S.A. 12-5040, the Hospital is required to allow qualifying retirees to participate in the group health insurance plan. While each retiree is required to pay the full amount of the applicable premium, conceptually, the Hospital is subsidizing the retirees because each participant is charged a level premium regardless of age. However, the cost of the subsidy, if any, has not been quantified in these financial statements.

Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Hospital makes health care benefits available to eligible former employees and their eligible dependents. Certain requirements are outlined by the federal government for this coverage. The premium is paid entirely by the insured and there is no cost to the Hospital under this plan.

9. CAPITAL ASSETS

Capital asset additions, disposals, and balances for the years ended December 31, 2011 and 2010 were as follows:

	Balance At December 31, 2010	Additions	Disposals	Balance At December 31, 2011
Capital assets not being depreciated:				
Land	\$ 86,142	\$ —	\$ —	\$ 86,142
Capital assets being depreciated:				
Land				
improvements	1,278,116	—	—	1,278,116
Buildings and fixed equipment	7,679,300	26,603	—	7,705,903
Movable equipment	5,302,282	316,819	—	5,619,101
Total capital assets being depreciated	14,259,698	343,422	—	14,603,120
Less accumulated depreciation for:				
Land				
improvements	453,608	60,243	—	513,851
Buildings and fixed equipment	2,936,754	401,866	—	3,338,620
Movable equipment	3,797,432	409,336	—	4,206,768

9. CAPITAL ASSETS (continued)

	Balance At December 31, 2010	Additions	Disposals	Balance At December 31, 2011
Total accumulated depreciation	\$ 7,187,794	\$ 871,445	\$ —	\$ 8,059,239
Total capital assets being depreciated, net	7,071,904	(528,023)	—	6,543,881
Total capital assets, net	<u>\$ 7,158,046</u>	<u>\$ (528,023)</u>	<u>\$ —</u>	<u>\$ 6,630,023</u>
	Balance At December 31, 2009	Additions	Disposals	Balance At December 31, 2010
Capital assets not being depreciated:				
Land	\$ 86,142	\$ —	\$ —	\$ 86,142
Capital assets being depreciated:				
Land				
improvements	1,278,116	—	—	1,278,116
Buildings and fixed equipment	7,669,538	9,762	—	7,679,300
Movable equipment	4,966,004	336,278	—	5,302,282
Total capital assets being depreciated	13,913,658	346,040	—	14,259,698
Less accumulated depreciation for:				
Land				
improvements	393,365	60,243	—	453,608
Buildings and fixed equipment	2,534,405	402,349	—	2,936,754
Movable equipment	3,444,089	353,343	—	3,797,432
Total accumulated depreciation	<u>6,371,859</u>	<u>815,935</u>	<u>—</u>	<u>7,187,794</u>

9. CAPITAL ASSETS (continued)

	Balance At December 31, 2009	Additions	Disposals	Balance At December 31, 2010
Total capital assets being depreciated, net	\$ 7,541,799	\$ (469,895)	\$ —	\$ 7,071,904
Total capital assets, net	\$ 7,627,941	\$ (469,895)	\$ —	\$ 7,158,046

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

Generally Accepted Accounting Principles (GAAP) establishes a single authoritative definition of fair value, sets a framework for measuring fair value and requires additional disclosures about fair value measurements. Financial instruments that are measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

- Level 1 – Quoted market prices are available in active markets for identical instruments as of the reporting date.
- Level 2 – Pricing inputs are observable for the instruments, either directly or indirectly, as of the reporting date, but are other than quoted prices in active markets as in Level 1.
- Level 3 – Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument.

The following methods and assumptions were used by the System in estimating the fair value of its financial instruments:

Cash and cash equivalents – The carrying amounts reported in the balance sheet for cash and cash equivalents approximates its fair value.

Accounts receivable – The carrying amounts reported in the balance sheet for accounts receivable approximates fair value because of the short-term nature of those instruments.

Estimated third-party payor settlements – The carrying amounts reported in the balance sheet for estimated third-party payor settlements approximates fair value because of the short-term nature of those instruments.

Accounts and other payables – The carrying amounts reported in the balance sheet for accounts and other payables approximates their fair value because of the short-term nature of those instruments.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Capitalized lease obligations – The fair value of these liabilities is estimated using discounted cash flow analyses, based on the interest rate implicit in the lease agreements.

General obligation bonds – The carrying amounts reported in the balance sheet for the bonds is their face value which approximates their fair value.

The carrying amounts and fair value of the System's financial instruments at December 31, 2011 and 2010 are as follows:

	<u>December 31, 2011</u>		<u>December 31, 2010</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Cash and cash equivalents	\$ 1,606,449	\$ 1,606,449	\$ 2,542,830	\$ 2,542,830
Accounts and other receivables	1,254,054	1,254,054	1,366,252	1,366,252
Estimated third-party payor settlements	480,703	480,703	82,878	82,878
Accounts and other payables	556,714	556,714	688,329	688,329
Capitalized lease obligations	499,731	499,731	648,754	648,754
General obligation bonds	4,885,000	4,885,000	5,225,000	5,225,000

11. COMPLIANCE WITH KANSAS LAW

Kansas statutes prohibit the expenditures of individual funds to exceed the adopted budget for such funds. For the year ended December 31, 2011, the operations and maintenance fund expenditures exceeded the adopted budget in the amount of \$628,553.

ADDITIONAL INFORMATION

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

OPERATION AND MAINTENANCE FUND

**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES – BUDGET AND ACTUAL – BUDGETARY BASIS**

Year ended December 31, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts Budgetary Basis</u>	<u>Variance With Final Budget Positive (Negative)</u>
Revenues:				
Net patient service revenue	\$ 9,919,412	\$ 9,919,412	\$ 12,207,310	\$ 2,287,898
Taxes	315,300	315,300	316,078	778
Other	<u>212,637</u>	<u>212,637</u>	<u>702,153</u>	<u>489,516</u>
Total revenues	<u>10,447,349</u>	<u>10,447,349</u>	<u>13,225,441</u>	<u>2,778,192</u>
Expenditures:				
Salaries	5,639,498	5,639,498	7,158,734	(1,519,236)
Employee benefits	2,193,130	2,193,130	1,965,242	227,888
Supplies and contractual services	4,402,031	4,402,031	3,848,255	553,776
Capital outlay	566,754	566,754	507,735	59,019
Transfers to Employee Benefits Fund	<u>50,000</u>	<u>50,000</u>	<u>—</u>	<u>50,000</u>
Total expenditures	<u>12,851,413</u>	<u>12,851,413</u>	<u>13,479,966</u>	<u>(628,553)</u>
Excess of revenue over (under) expenditures	(2,404,064)	(2,404,064)	(254,425)	2,149,639
Fund balance, beginning of year	<u>2,883,532</u>	<u>2,883,532</u>	<u>2,753,793</u>	<u>(129,739)</u>
Fund balance, end of year	<u>\$ 479,468</u>	<u>\$ 479,468</u>	<u>\$ 2,499,368</u>	<u>\$ 2,019,900</u>

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

EMPLOYEE BENEFITS FUND

**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES – BUDGET AND ACTUAL – BUDGETARY BASIS**

Year ended December 31, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts Budgetary Basis</u>	<u>Variance With Final Budget Positive (Negative)</u>
Revenues:				
Taxes	\$ 125,000	\$ 125,000	\$ 125,410	\$ 410
Transfers from operations and maintenance fund	<u>50,000</u>	<u>50,000</u>	<u>—</u>	<u>(50,000)</u>
Total revenues	175,000	175,000	125,410	(49,590)
Expenditures – Employee benefits	<u>175,000</u>	<u>175,000</u>	<u>125,410</u>	<u>49,590</u>
Excess of revenue over (under) expenditures	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Fund balance, beginning of year	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Fund balance, end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

DEBT SERVICE FUND

**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES – BUDGET AND ACTUAL – BUDGETARY BASIS**

Year ended December 31, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts Budgetary Basis</u>	<u>Variance With Final Budget Positive (Negative)</u>
Revenues – Taxes	<u>\$ 533,044</u>	<u>\$ 533,044</u>	<u>\$ 533,264</u>	<u>\$ 220</u>
Expenditures:				
Principal payments on bonds	<u>340,000</u>	<u>340,000</u>	<u>340,000</u>	<u>–</u>
Interest payments bonds	<u>556,372</u>	<u>556,372</u>	<u>206,372</u>	<u>350,000</u>
Total expenditures	<u>896,372</u>	<u>896,372</u>	<u>546,372</u>	<u>350,000</u>
Excess of revenue over (under) expenditures	<u>(363,328)</u>	<u>(363,328)</u>	<u>(13,108)</u>	<u>350,220</u>
Fund balance, beginning of year	<u>407,250</u>	<u>407,250</u>	<u>397,401</u>	<u>(9,849)</u>
Fund balance, end of year	<u>\$ 43,922</u>	<u>\$ 43,922</u>	<u>\$ 384,293</u>	<u>\$ 340,371</u>

ARTESIAN VALLEY HEALTH SYSTEM
a/k/a MEADE HOSPITAL DISTRICT
SCHEDULE OF PATIENT SERVICE REVENUE

		Year ended December 31,		
		2011		2010
	Inpatient	Outpatient	Total	Total
Adults and pediatrics	\$ 554,069	\$ 509,066	\$ 1,063,135	\$ 882,458
Swing beds	190,322	—	190,322	195,365
Long-term care unit	2,332,001	—	2,332,001	2,323,972
Operating room	278,292	1,278,152	1,556,444	1,237,557
Anesthesiology	93,129	259,543	352,672	335,132
Radiology	221,217	1,552,513	1,773,730	1,954,104
Laboratory	443,221	1,557,997	2,001,218	2,159,960
Respiratory therapy	521,747	153,475	675,222	720,398
Physical therapy	110,927	551,887	662,814	855,015
Cardiac rehabilitation	—	7,200	7,200	13,280
Electrocardiology	19,120	75,894	95,014	100,752
Medical supplies	1,020,151	598,811	1,618,962	1,556,652
Pharmacy	586,677	456,518	1,043,195	1,104,418
Home health	—	152,312	152,312	122,596
Home medical equipment	—	445,118	445,118	431,417
Emergency room	4,013	224,723	228,736	233,357
Heritage	—	—	—	141,978
Rural health clinic	—	1,365,179	1,365,179	1,433,543
Gross patient service revenue	\$ <u>6,374,886</u>	\$ <u>9,188,388</u>	15,563,274	15,801,954
Contractual adjustments			(2,670,346)	(2,934,064)
Charity care			(120,444)	(120,000)
Bad debts			<u>(565,174)</u>	<u>(425,860)</u>
Net patient service revenue			\$ <u>12,207,310</u>	\$ <u>12,322,030</u>

ARTESIAN VALLEY HEALTH SYSTEM

a/k/a MEADE HOSPITAL DISTRICT

SCHEDULE OF OPERATING EXPENSES BY FUNCTIONAL DIVISION

Department	Year ended December 31, 2011						Percent of total operating expenses
	Salaries	Employee benefits	Purchased services	Medical supplies and drugs	Other supplies/expense	Depreciation	Total
Routine service:							
Adult and pediatrics	\$ 1,070,103	\$ -	\$ -	\$ -	\$ 70,604	\$ 110,847	\$ 1,251,554
Long-term care unit	2,026,875	-	8,067	47,380	402,558	13,538	2,498,418
	<u>3,096,978</u>	<u>-</u>	<u>8,067</u>	<u>47,380</u>	<u>473,162</u>	<u>124,385</u>	<u>3,749,972</u>
							26.82
Ancillary services:							
Operating room	199,321	-	-	-	67,457	55,198	321,976
Anesthesiology	-	-	249,255	-	6,067	5,843	261,165
Radiology	235,885	-	-	-	135,652	102,967	474,504
Laboratory	264,398	-	48,202	-	339,551	45,212	697,363
Respiratory therapy	150,568	-	-	-	13,378	1,969	170,678
Physical therapy	231,912	-	17,041	4,763	20,487	8,018	277,458
Cardiac rehabilitation	6,118	-	-	-	8	-	6,126
Electrocardiology	990	-	-	-	14	8,260	9,264
Medical supplies	43,057	-	-	856,318	-	-	899,375
Pharmacy	89,101	-	17,391	217,590	-	28	324,110
Home health	172,503	-	-	-	14,602	1,039	188,144
Home medical equipment	66,814	-	-	30,983	-	765	98,562
Emergency room	191,392	-	2,340	-	4,367	2,171	200,270
Heritage	-	-	-	-	-	863	863
Rural health clinic	1,173,426	-	-	12,838	123,633	2,465	1,312,362
	<u>2,825,485</u>	<u>-</u>	<u>334,229</u>	<u>1,122,492</u>	<u>725,216</u>	<u>234,798</u>	<u>5,242,220</u>
							37.48
General services:							
Administration and general	648,667	-	128,284	-	491,355	20,287	1,288,593
Operation of plant	67,522	-	-	-	366,119	2,613	436,254
Laundry	-	-	-	-	214	6,503	6,717
Housekeeping	116,843	-	-	-	40,188	-	157,031
Dietary	149,586	-	4,254	-	66,885	11,002	231,727
Nursing administration	65,575	-	-	-	3,635	63	69,273
Medical records	127,809	-	-	-	21,795	8,366	157,970
Social services	-	-	3,000	-	-	-	3,000
Fitness	60,269	-	-	-	9,539	1,315	71,123
Employee benefits	-	2,090,652	-	-	-	-	2,090,652
Debt cost amortization	-	-	-	-	-	17,632	17,632
Depreciation - building	-	-	-	-	-	462,113	462,113
	<u>1,236,271</u>	<u>2,090,652</u>	<u>135,538</u>	<u>-</u>	<u>999,730</u>	<u>529,894</u>	<u>4,992,085</u>
							35.70
	<u>\$ 7,158,734</u>	<u>\$ 2,090,652</u>	<u>\$ 477,834</u>	<u>\$ 1,169,872</u>	<u>\$ 2,198,108</u>	<u>\$ 889,077</u>	<u>\$ 13,984,277</u>
							100.00 %

Department	Year ended December 31, 2010						Percent of total operating expenses
	Salaries	Employee benefits	Purchased services	Medical supplies and drugs	Other supplies/expense	Depreciation	Total
Routine service:							
Adult and pediatrics	\$ 1,124,490	\$ -	\$ -	\$ -	\$ 56,889	\$ 52,436	\$ 1,233,815
Long-term care unit	1,935,687	-	9,451	46,852	377,019	12,458	2,381,467
	<u>3,060,177</u>	<u>-</u>	<u>9,451</u>	<u>46,852</u>	<u>433,908</u>	<u>64,894</u>	<u>3,615,282</u>
							28.22
Ancillary services:							
Operating room	222,007	-	-	-	26,645	71,151	319,803
Anesthesiology	-	-	218,912	-	22,909	3,714	245,535
Radiology	231,430	-	-	-	114,250	85,880	431,560
Laboratory	266,099	-	57,004	-	386,753	45,476	755,332
Respiratory therapy	162,209	-	-	5,349	17,487	1,969	187,014
Physical therapy	271,361	-	-	-	31,871	6,891	310,123
Cardiac rehabilitation	8,528	-	-	-	834	-	9,362
Electrocardiology	3,474	-	-	-	58	8,534	12,066
Medical supplies	33,811	-	-	790,673	-	-	824,484
Pharmacy	79,277	-	17,893	242,555	-	28	339,753
Home health	150,294	-	-	-	13,540	1,039	164,873
Home medical equipment	62,304	-	-	23,592	-	839	86,735
Emergency room	176,658	-	-	-	8,011	2,171	186,840
Heritage	41,737	-	168,000	-	1,815	863	212,415
Rural health clinic	1,135,134	-	-	13,924	116,771	6,057	1,271,886
	<u>2,844,323</u>	<u>-</u>	<u>461,809</u>	<u>1,076,093</u>	<u>740,944</u>	<u>234,612</u>	<u>5,357,781</u>
							38.35
General services:							
Administration and general	641,965	-	109,421	-	377,438	22,989	1,151,813
Operation of plant	72,640	-	-	-	300,060	2,613	375,313
Laundry	60	-	-	-	-	6,503	6,563
Housekeeping	98,776	-	-	-	47,482	-	146,258
Dietary	144,037	-	5,832	-	72,210	11,002	233,081
Nursing administration	70,632	-	-	-	1,954	63	72,649
Medical records	122,054	-	659	-	23,444	9,962	156,119
Social services	-	-	3,000	-	-	-	3,000
Fitness	59,863	-	-	-	21,194	705	81,762
Employee benefits	-	1,966,366	-	-	-	-	1,966,366
Debt cost amortization	-	-	-	-	-	18,362	18,362
Depreciation - building	-	-	-	-	-	462,592	462,592
	<u>1,210,027</u>	<u>1,966,366</u>	<u>118,912</u>	<u>-</u>	<u>843,782</u>	<u>534,791</u>	<u>4,673,878</u>
							33.43
	<u>\$ 7,114,527</u>	<u>\$ 1,966,366</u>	<u>\$ 590,172</u>	<u>\$ 1,122,945</u>	<u>\$ 2,018,634</u>	<u>\$ 834,297</u>	<u>\$ 13,646,941</u>
							100.00 %